

Legislative Fiscal Bureau

Fiscal Note

SF 2318 – Insurance Tax Rate Reduction (LSB 7114 SV.1)

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Fiscal Note Version - Revised

Description

Senate File 2318 reduces the Iowa insurance premium tax rate from the present 2.0% to 1.0% over a four-year period. The tax for health and life insurance is reduced starting calendar year 2003 and the tax for property and casualty insurance is reduced starting calendar year 2004.

Under current law, a portion of the insurance premium taxes for a calendar year is pre-paid on June 1 of that calendar year. The pre-payment is equal to 50.0% of the insurance company's previous calendar year tax liability. The remainder of the premium tax for the year is due on March 1 following the end of the calendar year. The Bill increases the pre-payment percentage in stages from the current 50.0% to 100.0% over three years.

Current Iowa law requires that insurance companies domiciled in another state pay the Iowa rate of 2.0%, or the rate an Iowa company would pay in the state of residence of the company, whichever method produces the higher tax. This is referred to as a retaliatory tax, and it produces additional premium tax revenue from companies doing insurance business in Iowa and headquartered in a state with a higher tax on insurance companies. Therefore, reducing the Iowa tax rate is partially offset by an increase in retaliatory tax receipts.

Assumptions

1. Premium tax receipts in FY 2003 will equal \$145.7 million and will grow by 5.2% per year through FY 2010.
2. Of the projected tax revenue, 55.0% will be derived from life and health insurance and 45.0% from property and casualty insurance.
3. Reducing the Iowa insurance premium tax rate will increase the amount of tax defined as "retaliatory." That is tax received from non-Iowa companies domiciled in a state with a tax/fee schedule higher than the reduced Iowa rate. The amount of increased retaliatory tax based on the tax reductions specified in the Bill is provided in the Fiscal Impact table.
4. The insurance sales mix of domestic (Iowa-based) and foreign/alien (companies domiciled in other states) will not materially change from the present mix in future years.
5. A reduction in Iowa tax rates will not induce other states to reduce their tax rates.
6. Administrative costs for the Division of Insurance due to the rate reduction and additional filing period will be less than \$50,000 per year.
7. Because the Bill does not amend Section 518.18, Code of Iowa, county mutual insurance associations premium tax liability would remain at 2.0% and those entities would be at a competitive disadvantage.

Fiscal Impact

The premium tax reduction in SF 2318 will reduce General Fund revenues beginning in FY 2006. Small positive impacts are projected for FY 2004 and FY 2005. The increase in retaliatory tax revenue will moderate the revenue reduction to a degree. The projected revenue changes are as follows:

	Health & Life Tax Decrease	Property & Casualty Tax Decrease	Iowa Retaliatory Tax Increase	Total Fiscal Impact
FY 2003	\$ 0	\$ 0	\$ 0	\$ 0
FY 2004	- 3,152,000	0	3,468,000	316,000
FY 2005	- 9,585,000	- 3,724,000	13,815,000	506,000
FY 2006	- 41,424,000	- 8,724,000	22,634,000	- 27,514,000
FY 2007	- 58,865,000	- 31,459,000	30,521,000	- 59,803,000
FY 2008	- 50,099,000	- 28,288,000	24,276,000	- 54,110,000

Under the provisions of the Bill, health and life insurance companies would make prepayments equaling 100.0% of their calendar year 2005 tax liability in June of 2006 (FY 2006). The tax due in June 2006 is a prepayment of taxes due for calendar year 2006, and as a result of the tax rate for calendar year 2006 being 20.0% (1.00% versus 1.25%) lower than in calendar year 2005, the 100.0% prepayment will exceed the tax liability for calendar year 2006 for all or almost all companies. This would create a situation where the prepayment, collected in FY 2006, will cause known tax credits in FY 2007. A tax collected in one year that is known to be due in the next fiscal year could cause a Generally Accepted Accounting Principles (GAAP) issue. This same issue would occur with property and casualty insurance in the next fiscal year.

If assumption five above does not prove to be true, the amount of retaliatory tax specified in the table above would be reduced, and the negative fiscal impact of SF 2318 would be higher.

Source

Ernst & Young Premium Tax Studies

/s/ Dennis C Prouty

April 3, 2002

The fiscal note and correctional impact statement for this bill was prepared pursuant to Joint Rule 17 and pursuant to Section 2.56, Code of Iowa. Data used in developing this fiscal note and correctional impact statement are available from the Legislative Fiscal Bureau to members of the Legislature upon request.
